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SECTION 1 DEFINITION OF INTERNAL CONTROLS

The American Institute of Certified Public Accountants, in Statement on Auditing Standards number 55 (SAS 55), defines the internal control structure as “the policies and procedures established to provide reasonable assurance that specific entity objectives will be achieved”.

There are two aspects of internal control: internal accounting controls and administrative controls. Internal accounting controls are procedures designed to ensure the reliability of accounting data and to safeguard assets. Administrative controls deal with the operations of the library rather than with the accounting for those operations.

The legislative body of the library has a responsibility to ensure internal controls are in place to prevent misuse of funds (including fraud or embezzlement). Sections 2 through 5 address internal controls. Section 6 contains common indicators of potential fraud or embezzlement.

SECTION 2 INTERNAL CONTROL OBJECTIVES

There are four internal control objectives:

1. Safeguard assets
2. Accuracy and reliability of financial reporting and supporting information
3. Operational efficiency and effectiveness
4. Adherence with applicable laws and regulations

The first two objectives relate to internal accounting controls. These objectives are more specifically defined to provide reasonable assurance that:

- a. Transactions (e.g. cash receipts and cash disbursements) are executed in accordance with management’s general or specific authorization.
- b. Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets (e.g. cash).
- c. Access to assets is permitted only in accordance with management’s authorization.
- d. The recorded accountability for assets is compared with the existing assets (e.g. bank reconciliations) at reasonable intervals and appropriate action is taken with respect to any differences.

The last two objectives relate to administrative controls.

SECTION 3 INTERNAL CONTROL COMPONENTS

A) CONTROL ENVIRONMENT

The control environment originates with, and is generated by the board and library director. This sets the tone and provides discipline and structure for the library. Factors affecting the control environment include: management's philosophy and operating style, organizational structure, functioning of the board, personnel policies, methods of assigning responsibility, monitoring and supervision procedures, and external influences such as government regulations.

B) MONITORING / ACCOUNTING SYSTEM

SAS 55 defines the accounting system as "the methods and records established to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities". An effective accounting system will identify and record all valid transactions in the proper time period using appropriate classifications and will present those transactions properly in the financial statements.

C) CONTROL ACTIVITIES

Control activities are those policies and procedures developed by management to provide reasonable assurance that the organization's objectives will be achieved. Listed below are five categories of control activities. Under each category is a list of specific procedures that may be performed to satisfy that category.

1. Proper authorization of transactions.
 - The purchase of goods and services should be requested by one person and approved by another.
 - Libraries should adopt a payment authorization procedure. For example, two signatures could be required on all checks greater than a certain amount. If a library's payment authorization procedure requires board approval of disbursements, the board should have a mechanism for approving disbursements in the absence of a quorum at board meetings.
 - Creating and using budgets is a form of authorization.
 - Individuals that handle cash should be bonded (fidelity bond).
2. Segregation of duties. This includes assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets.
 - The person collecting cash should not be the person who records the cash receipt.
 - If there is enough staff, a rotation of duties can eliminate employee manipulation of records or assets.
 - The approval of purchases should not be made by the person who has access to the checks.

3. Design and use of adequate documents and records to help ensure the proper recording of transactions and events.
 - Pre-numbered checks, receipts and purchase orders should be used and sequence should be accounted for.
 - Cancelled checks, vouchers, and receipts should be maintained.
 - Voucher packages (invoices, purchase orders and receiving reports) should be cancelled (stamped paid) after payment to prevent duplicate payments.
 - Invoices should be matched to receiving reports and receiving reports should be matched to purchase orders to ensure that you received what you ordered and you only pay for what you received.
 - Journals should be kept for all transactions.
4. Adequate safeguards regarding access to and use of assets and records.
 - Access to blank checks, signature plates, and purchase orders should be restricted.
 - Computers should have passwords to access and change information.
 - Work areas should be visible to supervisors.
 - Voided checks should be defaced by tearing the signature line off or writing void on the face of the check. All voided checks should be maintained.
5. Independent checks on performance and proper valuation of recorded amounts.
 - Bank reconciliations should be performed monthly.
 - Bank reconciliations should be reviewed periodically by someone other than the preparer.
 - Calculations should be checked for clerical accuracy.
 - Independent personnel should perform periodic cash counts of the petty cash account.
 - There should be supervisory review over daily operations.

SECTION 4 INHERENT LIMITATIONS OF CONTROLS

Inherent limitations on internal controls of a library are inevitable. Human error, deliberate circumvention and cost/benefit considerations are factors that must be considered when implementing or analyzing a library's internal controls. The size and resources of a given library should also be taken into consideration. Larger libraries generally have greater resources which can be used to develop and implement more fool proof controls. However, larger libraries generally have a need for more fool proof controls due to the number of employees, transactions and resources that a larger library may be responsible for. Because of the inherent limitations of controls, it is important for libraries to have written documentation of their internal controls. The documentation can be in many forms, including written narratives, flowcharts and checklists. This documentation provides employees with clear precise procedures to follow when performing various functions and allows for easy follow up and investigation in situations that warrant it.

SECTION 5 INTERNAL CONTROL QUESTIONNAIRE

The accompanying questionnaire can be used as a tool to identify areas where internal controls are weak or could be improved. Any "No" answer is indicative of a potential internal control weakness. Consideration should be given to changing existing procedures, where practical and cost beneficial, so that a "yes" answer can be given to the question. It is possible that a "yes" answer still cannot be given. This is often the case for small libraries that may only have one individual to perform financial functions. If a "yes" answer still cannot be given, consult with your CPA to ensure that sufficient offsetting factors exist.

		Answer	
		Yes	No
I. CASH RECEIPTS			
1.	Is the mail opened by someone other than the library's bookkeeper (e.g. the Library Director)?		
2.	Are receipts recorded by cash registers or other mechanical devices?		
3.	If not, is a separate cash drawer used that is kept locked when unattended?		
4.	Are each day's receipts deposited in the bank intact and without delay?		
5.	Does someone other than the bookkeeper (e.g. the Library Director) take the deposits to the bank?		
6.	When branch libraries make collections, are such collections deposited in a bank account subject to withdrawal only by the main library?		
7.	Are rents, taxes, interest, and similar revenues adequately controlled in such manner that their nonreceipt would be noted and investigated?		

		Answer	
		Yes	No
II. CASH DISBURSEMENTS			
1.	Are all disbursements, except from petty cash, made by check?	_____	_____
2.	Are all checks prenumbered?	_____	_____
3.	Are voided checks properly defaced or mutilated and held available for subsequent inspection?	_____	_____
4.	Are checks required to be countersigned by the treasurer or a board member?	_____	_____
5.	Is the signing of checks in advance prohibited?	_____	_____
6.	Is the library bookkeeper prohibited from signing checks?	_____	_____
7.	Is the practice of drawing checks to "cash" or "bearer" prohibited?	_____	_____
8.	If not, are checks so drawn limited to payrolls and/or petty cash reimbursement?	_____	_____
9.	Are the bank accounts reconciled monthly?	_____	_____
10.	Is the sequence of check numbers accounted for when reconciling the bank accounts?	_____	_____
11.	Is the practice of examining paid checks for date, name, cancellation, and endorsement followed by the employee reconciling the bank accounts?	_____	_____
12.	Are the invoices or other supporting documents presented together with the checks submitted for signatures?	_____	_____
13.	Do the signers review invoices for propriety and appropriateness of account assigned and compare check amounts to invoices before signing checks?	_____	_____
14.	If a check-signing machine is in use, are the machine and signature plates kept under effective control?	_____	_____
15.	Is the supply of blank checks under effective control?	_____	_____
16.	Are the supporting documents cancelled with a "paid" stamp or other mark so as to prevent their use for duplicate payment?	_____	_____

		Answer	
		Yes	No
III. PETTY CASH			
1.	Is the imprest petty cash (i.e., fixed amount of cash) account system in use?	_____	_____
2.	Is the responsibility for the petty cash account vested in one person only?	_____	_____
3.	Is the petty cash account kept separate from daily cash receipts?	_____	_____
4.	Is disbursement of daily cash receipts prohibited?	_____	_____
5.	Has a maximum figure for individual payments from the petty cash account been established?	_____	_____
6.	Are payees required to sign petty cash vouchers for all disbursements?	_____	_____
7.	Is adequate approval required for petty cash advances to employees?	_____	_____
8.	Is the cashing of personal checks and IOUs prohibited?	_____	_____
9.	a. Are vouchers and supporting documents (invoices and receipts) checked by a responsible employee at the time the petty cash account is reimbursed?	_____	_____
	b. Does that employee verify the unexpended balance of the petty cash account?	_____	_____
10.	Are the amounts of the vouchers spelled out in words as well as written in numerals?	_____	_____
11.	Are petty cash vouchers marked "paid" so as to preclude their reuse?	_____	_____
12.	Are checks for reimbursement made out to the order of the petty cash custodian rather than to "cash"?	_____	_____
13.	Is the petty cash account checked at reasonable intervals by surprise counts made by an employee independent of the custodian of the account?	_____	_____
		Answer	
		Yes	No
IV. INVESTMENTS			
1.	Are securities kept in a safe deposit vault in the name of the library?	_____	_____
2.	If not, are they kept in safekeeping by an independent person?	_____	_____
3.	Is a record kept by the bookkeeper of each security, including certificate numbers?	_____	_____
4.	Are securities periodically inspected and reconciled with the records by an employee other than the bookkeeper?	_____	_____
5.	Are purchases and sales of securities authorized by the board, a board committee, or an officer?	_____	_____
6.	Are satisfactory records kept to ensure the proper and prompt receipt of income on securities owned?	_____	_____
7.	Has an investment policy been adopted by the board and have all financial brokers, bankers and trustees agreed in writing to comply with the policy?	_____	_____
8.	Are the provisions of the investment policy being followed?	_____	_____

		Answer	
		Yes	No
V.	PURCHASES AND EXPENSE/EXPENDITURES		
1.	Is the budget reviewed before ordering goods?	_____	_____
2.	Are vendors' invoices recorded in the accounts payable journal immediately upon receipt?	_____	_____
3.	Are the invoices checked:		
	a. Against purchase orders?	_____	_____
	b. Against receiving reports (as to quantity and condition)?	_____	_____
4.	Are invoices approved for payment by a responsible official?	_____	_____
5.	Is there a definite responsibility for the checking of invoices as to:		
	a. Prices and credit terms?	_____	_____
	b. Clerical accuracy?	_____	_____
	c. Freight charges or allowances?	_____	_____
6.	Is a designated employee made responsible for the determination of the proper account distribution of invoices (pursuant to an established accounting policy) to general ledger accounts?	_____	_____
7.	Are the vouchers, supporting invoices, and account distributions reviewed and initialed by an employee other than the bookkeeper before payment is authorized?	_____	_____
8.	Is a listing of outstanding accounts payable balanced monthly with the general ledger account?	_____	_____
9.	Are statements received from vendors regularly checked by the bookkeeper against the open accounts payable listing?	_____	_____
10.	Is a postage meter used for outgoing mail?	_____	_____

VI. PAYROLL

Because there is a wide range of library sizes and a wide range of number of employees at libraries, it is difficult to develop generic internal control guidelines for payroll. However, the following concepts concerning payroll would apply for all libraries:

- Employees should be paid only for those hours worked
- Employees should be paid at the correct rate of pay

Libraries should ensure that an appropriate official performs a review of the appropriate records to verify that employees are paid for hours worked at the correct rate of pay. An appropriate official may be a board member, library director or department head.

SECTION 6

COMMON INDICATORS OF POTENTIAL FRAUD OR EMBEZZLEMENT

Following are several common indicators of potential fraud or embezzlement at your library. To the extent these situations exist, further investigation is recommended.

- You notice lifestyle changes in an employee that opens the mail, accounts for cash or signs checks.
- An employee's life style appears inconsistent with their income level.
- An employee is overly nervous about audits.
- An employee will not share duties.
- An employee that handles cash or sign checks does not take allowed vacations.
- An employee works excessively on weekends or after business hours.
- A suspect employee is experiencing personal financial difficulties.
- None of the library's forms or documents are pre-numbered.
- Petty cash is missing.
- Sudden and unexplained overdrafts are occurring in the checking account.
- Duplicate or out-of-sequence check numbers are appearing on the bank statement.
- Cancelled checks returned from the bank have a different font or ink than normal.
- Non-payroll checks have been issued payable to employees.
- Payees on cancelled checks do not match entries in the general ledger.
- Invoices are being received for goods or services normally not purchased by the library.
- Invoices are being received that are not prepared/printed professionally or lack detailed information (e.g., phone or fax number, invoice number, description of goods, etc.).
- Payments are being made to unusual vendors or in unusual amounts.
- Payments to regular vendors are being made at unusual times.
- Duplicate or over-stated payments to vendors have been made.